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Annual Report 1977



File
MERLAND EXPLORATIONS LIMITED

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HIGHLIGHTS

	1977	1976	1975	1974	1973
PRODUCTION					
GAS — Billions Cubic Feet	11.5	9.6	7.3	5.5	1.6
— Millions Cubic Feet Per Day	31.6	26.3	20.1	15.1	4.4
OIL — Barrels	64,556	42,172	15,770	6,315	430
— Barrels Per Day	176.9	115.5	43.2	17.3	1.2
ACREAGE (000 Acres)†					
Gross	886	493	487	600	420
Net	297	162	165	236	130
DRILLING RECORD					
WELLS DRILLED (Gross)					
Oil	14	14	11	7	1
Gas	98	61	121	68	82
Dry	21	28	13	11	24
PRODUCTIVE WELLS (Cumulative)					
Gross	687	600	536	409	240
Net	369	326	290	215	175
FINANCIAL (\$000)					
Sales (Net of Royalties)	9,383	5,698	2,594	976	189
Cash Flow from Operations	5,469	3,106*	1,850	582	185
Net Earnings (Loss)	1,915	1,142	587	109	(55)
PER SHARE (Cents)					
Cash Flow from Operations	92.7	62.0*	39.8	12.5	4.4
Net Earnings (Loss)	32.4	22.7	12.6	2.3	(1.3)

* Restated

† As of Date of Reports



TO THE SHAREHOLDERS:

During the year 1977 the fortunes of MERLAND EXPLORATIONS LIMITED continued to increase and improve according to the plans set out at the beginning of the year.

Following a very successful year in 1976, MERLAND entered the year 1977 with more financing and confidence than in any other previous year. A policy of continued expansion in the shallow to medium depth gas areas of Alberta and Saskatchewan continued, however in 1977 MERLAND instituted the policy of increasing its land holdings in Alberta, British Columbia, Saskatchewan and several states in the United States of America. In addition MERLAND is participating in new and deeper projects with new and well established partners in these areas. These activities have now established MERLAND as one of the most active and successful junior oil and gas companies in Canada.

Cash flows from MERLAND's gas and oil production in East Texas increased substantially in 1977 with a much larger increase expected in 1978 as more of the projects are put on production. Cash flows from oil and gas projects in Alberta and Saskatchewan also increased during 1977 as additional wells were drilled in existing projects and new wells were drilled, completed and put on production in new projects.

PRODUCTION

MERLAND's daily gas production during 1977 averaged 32 MMCF/D as compared with 26.3 MMCF/D in 1976 resulting in an increase of 22%. The overall increase in natural gas production and sales for the industry in Canada in the year 1977 was approximately 6%. Gas production in most areas of Alberta and Saskatchewan was severely curtailed or completely shut down during several months due to the gas purchasers' (TransCanada Pipelines and Many Islands Pipe Line) inability to market the gas. As a result minimum contracted volumes were sold. Even though these restrictions and cutbacks occurred, MERLAND was able to put substantially all of its new gas reserves on production at the minimum amounts under existing sales contracts.

This gas marketing problem, common throughout Alberta, resulted in a substantial reduction in MERLAND's predicted gas sales volumes for the year. Although it is expected that this situation will continue for some time, the long-term outlook for natural gas markets is favourable.

Several of MERLAND's newly developed gas areas, such as Birch Wavy and Hilda, were drilled during the latter part of 1977 and put on production near the end of 1977 and early 1978 and will therefore result in increased production volumes in 1978.

In East Texas, the C.E. Turner #1 well was put on production from the Cotton Valley Lime and the Bossier Sand Formations in August 1977 which marked the beginning of large volume production from our United States properties.

At the end of 1977, MERLAND's gas sales were averaging approximately 39.5 MMCF/D from all areas in Canada and the United States as compared to the 1977 average of 32 MMCF/D.

Production of crude oil and natural gas liquids averaged 160 BPD as compared with 116 BPD in 1976 for an increase of 40%.

It should be noted that a few of MERLAND's projects such as Conlac, will reach a payout status during 1978 at which point MERLAND's interest will be reduced according to the terms of the farmout agreements. However, the lower cash flows from these projects will be more than offset by new or increased production from other properties, particularly in the United States.

FINANCIAL

During 1977 the number of shares issued by MERLAND EXPLORATIONS LIMITED was increased from 5,072,800 to 5,934,777, an increase of 861,977 or 17%. This increase in outstanding shares was due mainly to the convertible income debenture issued in 1976.

Gross revenues from the sale of oil and gas during the year 1977 were \$14,500,000, an increase of 58% over 1976 which increased the cash flow from operations by 76% over 1976 to \$5,500,000 or 92.7 cents per share. Net

earnings for 1977 increased by 67% over 1976 to \$1,900,000 or 32.4 cents per share.

Early in 1978 MERLAND renegotiated its lines of credit with its bankers to provide for the ongoing exploration and development program. In this regard, MERLAND has entered into an agreement with its bankers to issue a floating rate, ten year income debentures in the principal amounts of \$20,000,000 Canadian and \$7,000,000 U.S. While the lines of credit have been arranged, the borrowing in the form of Income Debentures will be subject to a favourable tax ruling from the Department of National Revenue.

During 1977 exploration and development expenditures totaled \$10,800,000. Approximately 75% of this amount was spent in Canada with the remainder in the United States. Of the total 1978 exploration and development budget of approximately \$15,000,000, 70% is projected to be spent in Canada and the remaining 30% to be spent in the United States.

PERSONNEL

There is no doubt that one of the most important assets of any company is its employees. Because MERLAND operates most of its properties in Canada we have found it necessary to organize and develop a full, well rounded staff that is capable of supervising or carrying out most oil and gas activities that may arise. MERLAND's staff is now nearly complete and I am very pleased with the dedication and ability demonstrated by the present personnel.

During 1977 MERLAND instituted an employee stock purchase plan whereby the employees may now become owners of MERLAND stock. MERLAND also initiated a profit sharing plan which provides the employees with the opportunity to share in Company profits.

OUTLOOK

With its enlarged financial base, MERLAND intends to continue its policy of increasing land holdings, oil and gas reserves, and production in Canada and the United States. The company will also continue to develop its existing acreage as required to maintain production at the maximum possible level. In the United States, the year 1978 should see the beginning of gas production from the C. H. Admire #1 and the Mitchell Creek well. A second well is now being drilled in the North Simsboro Project which would add to the production income presently being obtained from the C. E. Turner #1 well. Gas production should also begin from a host of wells in the Canus South and Southwest project areas of Texas such as Sampson, Goliath, Maguelitos, Cage Ranch and Hamilton Ranch. These projects should generate sufficient cash flow to finance the future United States drilling programs as they become available.

It is planned to continue exploration for oil and gas in East, South and Southwest Texas during the forthcoming year and to participate in other worthwhile exploration ventures in the United States as they become available.

In Canada the largest portion of MERLAND's exploration and development budget will be spent in Alberta as the chances of finding economical reserves of oil and gas are higher in this province. The company is however, planning to spend increasing amounts of exploration funds in British Columbia and Saskatchewan as opportunities arise.

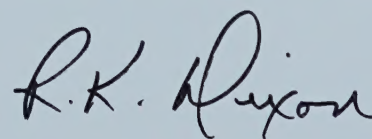
Government policies are having an ever increasing influence on the oil and gas industry in North America and these political factors must be considered when planning a broad exploration and development program. In Alberta, where chances of finding commercial oil and gas are excellent, government royalties are increasing, land prices are skyrocketing and new gas sales contracts are difficult or impossible to obtain. The Alberta Government has still not issued its long awaited policy regarding lower Crown Royalties for low volume, high capital shallow gas production.

The Province of Saskatchewan established a new gas price schedule in 1977 which increased MERLAND's selling price from 26¢ per MCF to 40¢ per MCF. This move increased MERLAND's cash flow from this area substantially, however the cash flow from Saskatchewan is still generally much less than from the other Canadian provinces. There is hope of further increases of gas prices in Saskatchewan as well as additional gas sales contracts. These possible benefits combined with the lower royalties and exploration and development costs in Saskatchewan have enhanced the economics of expanding operations in this province and our company hopes to expand its investment in this province during 1978.

The new oil and gas exploration and sales regulations introduced by the Government in British Columbia has made this province the most desirable oil and gas investment area in Canada. MERLAND hopes to increase its land and exploration investment in this province during 1978.

The economics of investing in the oil and gas industry in the United States are still superior to other areas because of ready markets, higher prices and lower royalties and land costs. MERLAND will therefore be investing increasing amounts in that country.

The board of directors believes that in spite of the present marketing difficulties in the natural gas industry in Canada, 1978 will be a year of substantial and sustained growth of reserves, cash flow and earnings for your Company.



President

April 24, 1978
Calgary, Alberta

ALBERTA

CONROY



COWPAR



WANDERING RIVER



GIROUX LAKE



NORTH BIG BEND



MORSE LAKE

WESTLOCK



SEIBERT LAKE



EDMONTON



HOLDEN



VIKING



BIRCH WAVY



JARROW

HALKIRK



HAMILTON LAKE



WIMBORNE



CALGARY



BANTRY



NORTH MEDICINE HAT



HILDA



SAND HILL

HORSHAM



CONLAC-VALE

MEDICINE HAT



ALDERSON



TABER

WINNIFRED



LETHBRIDGE



CANADIAN
PRODUCING PROPERTIES



OIL

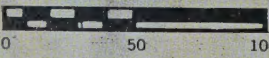


GAS



EXPLORATION PROJECTS

INDEX MAP



SCALE IN MILES

MERLAND EXPLORATIONS LIMITED
CALGARY — ALBERTA



OPERATIONS

MERLAND EXPLORATIONS LIMITED and its wholly owned United States subsidiary MERLAND RESOURCES, INC. are participating in a wide variety of oil and gas development and producing projects in Canada and the United States. The following is a brief resume of some of the more active projects in which MERLAND participated during the year 1977:

CANADA

CONLAC

MERLAND's production from this property increased from 4.5 BCF or 12.3 MMCF/D in 1976 to 5.0 BCF or 13.7 MMCF/D in 1977. Six additional wells were drilled on this property in 1977 making an existing total of 127 wells. This property has exhibited excellent performance for a shallow gas property, as a result MERLAND increased its after payout ownership from 50% to 61.83% in the Milk River Formation during 1977. Payout is expected in late 1978.

MERLAND has now obtained a total of approximately 18.8 BCF from this project since it commenced production in 1973.

HORSHAM

The price for gas produced from this Saskatchewan property increased from 26 cents per MCF to 40 cents per MCF during 1977 which was a significant increase even though it is still much below that of other provinces.

Two additional wells were drilled, completed and tied-in on this property in 1977 in an attempt to offset the natural decline in production. There are 26 wells presently producing on this property at an average rate of 134 MCF/D.

JARROW

Six wells were drilled, completed and tied-in on this property in 1977 which resulted in increasing MERLAND's net daily gas production rate from 1,130 MCF/D to 1,910 MCF/D. MERLAND's daily gas producing rate from this project was approximately 3,000 MCF/D at the end of 1977 and we will be relying heavily on this property for a substantial portion of our cash flow in the future.

BIRCH WAVY

Birch Wavy is a new project to the MERLAND portfolio. It is located immediately east of the Jarrow project and was pursued and developed because MERLAND had available gas sales contracts in the area.

MERLAND drilled five wells in the area during 1977 of which four were completed. MERLAND also purchased varying interests in seven shut-in gas wells in the area. A gas gathering system and a compressor station were installed and six of these wells were put on production by the end of the year. A second gas compressor station is under construction and two additional wells will be put on production in early 1978.

In addition to increasing MERLAND's net gas reserves substantially, this area will contribute approximately 2,300 MCF/D of net gas production to MERLAND in 1978.

NORTH BIG BEND

MERLAND's net gas production from this project increased from 126 MCF/D to 390 MCF/D during 1977. During the early part of 1978 MERLAND participated in the drilling of an exploratory well on this project located at 10-16-67-26 W4M which resulted in a very significant multi-zone gas discovery. This well will be put on production immediately and will significantly increase MERLAND's income in the area.

This property has now become a very valuable "dark horse" and attempts will be made to increase MERLAND's land holdings in the area.

TABER

A total of nine wells were drilled on the project in 1977, of which six were completed as successful oil wells and three were abandoned. There are now 15 producing wells in the field which were producing a total of approximately 800 BOPD at the end of 1977. This production rate is expected to increase to 1000 BOPD in early 1978 as the electrification of the field is completed.

"Good Production Practices" was recently granted to the two major oil pools by the Alberta Energy Resources Conservation Board which will result in an increased allowable for these pools.

Three to five infill development wells are planned for this project in 1978.

NORTH MEDICINE HAT

MERLAND's share of production from this project increased from 820 MCF/D to 2,300 MCF/D in 1977 and the project has now become very important to MERLAND's income. Four additional multi-zone wells were drilled and completed in 1977 which were placed on production in early 1978 resulting in an increase in MERLAND's producing capability to over 3,000 MCF/D.

BANTRY

MERLAND's gas production from the Bantry Area averaged 2,530 MCF/D in 1977 compared with 2,543 MCF/D in 1976.

A total of eight wells were drilled in the area in 1977 resulting in the completion of five shallow gas wells and three deeper Bow Island Sand wells.

The direct oxidation gas sweetening plant came on stream in mid 1977, however operational problems with this plant prevented maximum production of the sour gas reserves. A total of 147 MMCF of sour gas was produced and sweetened through the plant during 1977 and it is hoped that this volume can be increased in the future as the present plant operational problems are solved.

It is planned to drill several additional wells in this project and to rework a number of existing wells in 1978 which should result in a substantial increase in gas production.

WESTLOCK

MERLAND's net gas production from the Westlock Field increased to an average of 751 MCF/D in 1977 from 164 MCF/D in 1976 and was averaging approximately 1,300 MCF/D at the end of the year. This increase in production was due to the drilling of five additional wells during the year, two of which were tied in and put on production. The remaining wells will be put on production in 1978 to further increase gas production.

One of the wells drilled in 1977, located at 7-3-60-26 W4M, resulted in a new Belly River Formation discovery which will add to the Viking and Basal Quartz gas reserves in the area.

Operational problems with the direct oxidation gas sweetening plant, similar to those at Bantry, have allowed only a minimum of sour gas production from this area. It is hoped that these problems can be solved in the near future enabling a further increase in production.

CRUDE OIL AND NATURAL GAS SALES (Net)

Project	1977	1976
Natural Gas (MMCF)		
BANTRY	923,625	928,298
*BIRCH WAVY	15,426	—
CONLAC ET AL (GBI)	5,105,724	4,542,195
VALE	1,550,981	1,508,645
HORSHAM	688,106	748,574
HALKIRK	315,989	179,461
SOUTH ALDERSON	72,248	52,714
NORTH BIG BEND	142,311	45,856
NORTH MEDICINE HAT	839,443	294,378
WESTLOCK	274,218	64,947
JARROW	696,263	415,985
HOLDEN	314,832	281,815
EAST TEXAS—ORBIT	107,653	—
EAST TEXAS—CANUS	35,829	—
ELKWATER	515,747	426,152
**WEST VIKING UNIT	—	109,279
OTHERS	28,838	4,194
TOTAL	11,537,233	9,602,493
Crude Oil (Bbls)		
CECIL	5,028	6,587
RED COULEE	5,763	8,340
TABER	40,543	24,715
EAST TEXAS—CANUS	12,177	2,530
OTHERS	1,045	—
TOTAL	64,556	42,172

*On stream December 23, 1977.

**Property sold during 1976.

UNITED STATES

NORTH SIMSBORO

The # C. E. Turner well completed drilling in 1977 and was subsequently completed in the Cotton Valley Lime and Bossier Sand Formations. At the year's end the well was producing at a rate of 6,000 MCF/D of sweet gas and 40 BPD of condensate. MERLAND owns an initial interest of 24.5% in this well. An offset to the #1 C. E. Turner well is planned for early in 1978 and is presently drilling.

The inauguration of gas production from this project marks the beginning of large-volume production from MERLAND's projects in the United States which will contribute significantly to our cash flow in the future.

GRAND SALINE

Two Rodessa wells were drilled in 1977 making a total of six wells drilled, completed and put on production in this project. No additional wells are planned unless secondary recovery studies indicate that more wells are necessary.

A gas sales contract was signed for gas production from the C.H. Admire #1 well. A pipeline is presently being installed to this project and the well will be put on production in the second quarter of 1978.

MITCHELL CREEK

During 1977 a gas purchase contract was also signed for gas production from this project. Production equipment and a pipeline is presently being installed at the Mayes #1 well and this well should be put on production in mid 1978.

SOUTH AND SOUTHWEST TEXAS

During 1977 MERLAND RESOURCES, INC. participated in a number of exploration and development wells in South and Southwest Texas. In the deep drilling South Texas Area near the city of Corpus Christi the exploration wells of #1 Woodman Evans in the Goliath Prospect, the #1 Wilson, #1 Kelly and #1 Flato Driscoll wells in the Sampson Prospect, all encountered multiple high pressure sweet gas bearing sands in the deeper formations below 10,000 feet. All of these wells are either now on production or will be put on production immediately at high rates into adjacent natural gas sales facilities. The natural gas in this area is generally very rich in condensate and natural gas liquids which will add additional cash income from these projects.

Additional exploration and development drilling will be carried out on these projects and adjacent projects as soon as drilling equipment becomes available.

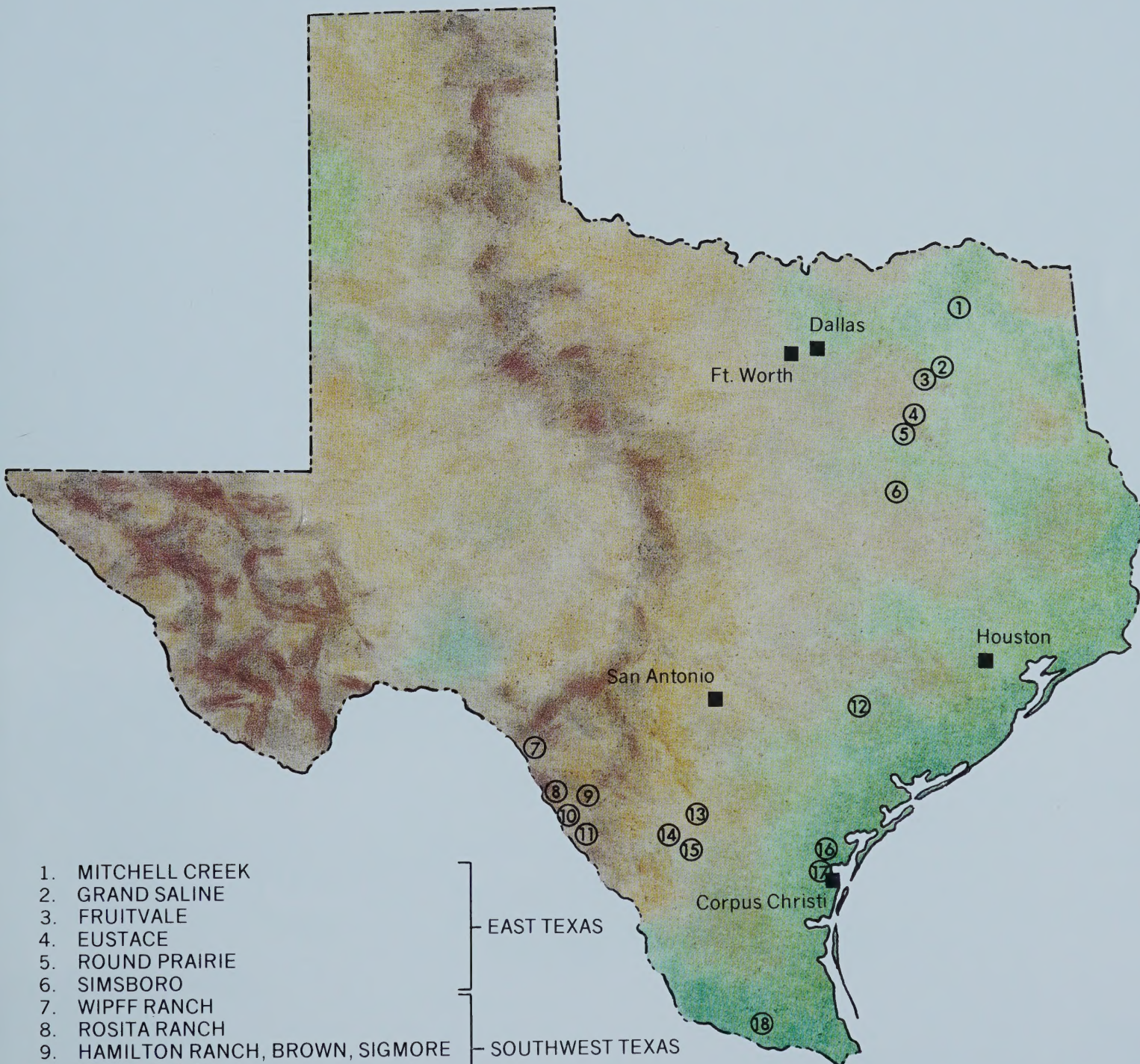
This area is rapidly becoming one of MERLAND's high investment and high revenue producing areas in the United States.

One exploration well was drilled on each of the Maguellitos and Midway Projects of South Texas. Each of these wells resulted in commercial gas finds which have been put on production. The wells are now being evaluated before additional wells are drilled.

In the Southwest Texas Area, MERLAND RESOURCES, INC. participated in several exploration and development wells in 1977 which resulted in commercial gas finds in two projects.

In the Cage Ranch Project, six successful wells have been drilled and completed, one of which has been put on production. The remaining wells will be put on production in the very near future as pipeline facilities are expanded. Additional drilling will be carried out in this area once the present wells are evaluated.

Six successful exploration and development gas wells were drilled on the Hamilton Ranch Prospect, one of which has been put on production to date. Additional gas transmission facilities are being installed into this area and it is expected that the remaining wells will be put on production in mid 1978.

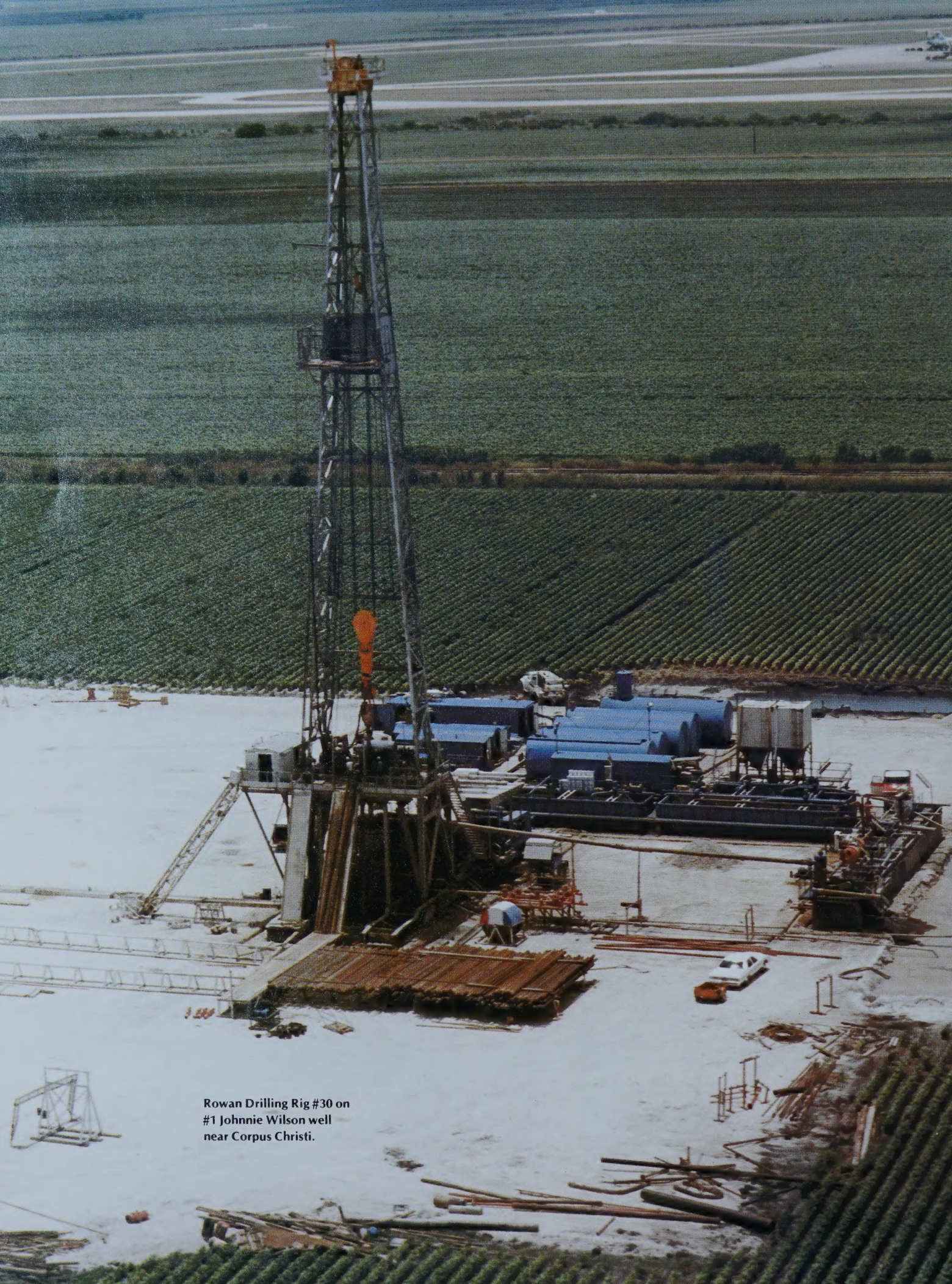


1. MITCHELL CREEK
2. GRAND SALINE
3. FRUITVALE
4. EUSTACE
5. ROUND PRAIRIE
6. SIMSBORO
7. WIPFF RANCH
8. ROSITA RANCH
9. HAMILTON RANCH, BROWN, SIGMORE
10. STONE RANCH
11. CAGE
12. NEW HOPE
13. MIDWAY
14. MILLER
15. MAGUELLITOS
16. PARKS, SODVILLE
17. SAMPSON, SAXET, GOLIATH
18. SHARY, SHEPHERD

EAST TEXAS

SOUTHWEST TEXAS

SOUTH TEXAS



Rowan Drilling Rig #30 on
#1 Johnnie Wilson well
near Corpus Christi.

EXPLORATION AND DEVELOPMENT

MERLAND EXPLORATIONS LIMITED and its wholly owned U.S. subsidiary MERLAND RESOURCES, INC. participated in the drilling of 126 wells during 1976. These wells could be categorized as follows:

Exploration wells in the United States	20
Development wells on old projects in the United States	2
Development and exploration wells on old projects in Canada	89
Exploration wells on new acreage in Canada	15

Of these wells, 18 were abandoned and the remaining 108 wells were completed as oil and/or gas wells.

LAND HOLDINGS

During the year 1977 MERLAND EXPLORATIONS LIMITED and MERLAND RESOURCES, INC. embarked on an aggressive campaign to increase its exploration and development acreage. As a result of these stepped-up efforts, our land holdings in British Columbia, Alberta, Saskatchewan and in the United States have been increased substantially.

New areas in which MERLAND's land holdings were established or increased are as follows:

Alberta — Birch Wavy	U.S.A. — East Texas
— Giroux	— South Texas
— Princess	— Southwest Texas
— Cowpar	— New Mexico
— Seibert Lake	British Columbia — Conroy
— Morse River	Saskatchewan — Sand Hills
— Wimborne	

Exploration wells will be drilled on this new acreage as necessary in order to fulfil commitments or to more fully evaluate the lands.

At the writing of this report MERLAND EXPLORATIONS LIMITED is participating in 742,301 gross acres and 276,731 net acres in the three Western provinces of Canada. This compares to a total of 485,749 gross acres and 160,728 net acres at the end of 1976 for an increase of 53% and 72% respectively. MERLAND RESOURCES, INC. is presently participating in 143,912 gross acres and 20,340 net acres in the United States as compared with 12,671 gross acres and 2,474 net acres at the end of 1976 for increases of 1,035% and 722% respectively.

All of this acreage is located in highly prospective or proven areas of Canada and the United States. MERLAND's plans are to continue to increase its land inventory at every opportunity in the future.

The location of MERLAND's existing acreage can be broken down and summarized as follows:

	Net Acres		Gross Acres	
	1977	1976	1977	1976
British Columbia	6,183	—	18,550	—
Alberta	210,350	154,724	658,640	474,832
Saskatchewan	60,198	6,004	65,111	10,917
Total Canada	276,731	160,728	742,301	485,749
Texas	19,700	2,474	138,792	12,671
New Mexico	640	—	5,120	—
Total U.S.A.	20,340	2,474	143,912	12,671
GRAND TOTAL	297,071	163,202	886,213	498,420

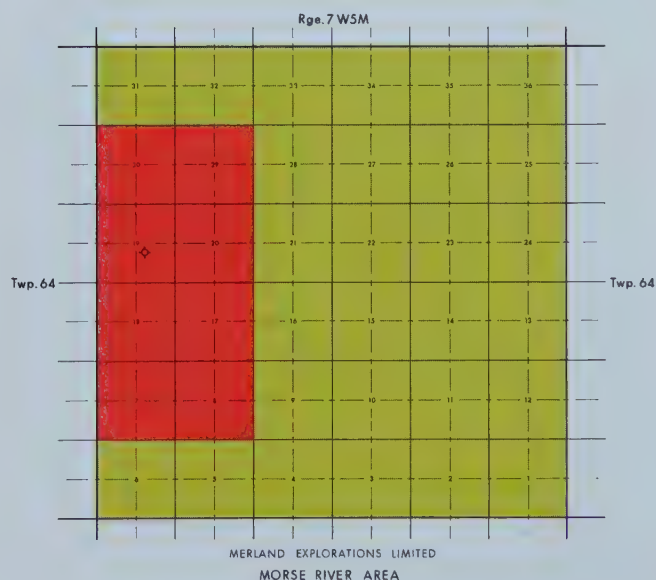
The following is a brief description of several of the new land and exploration projects entered into by MERLAND during the past year. It should be noted that several of these areas are undergoing active exploration activities, and as a result some information cannot be disclosed at this time.

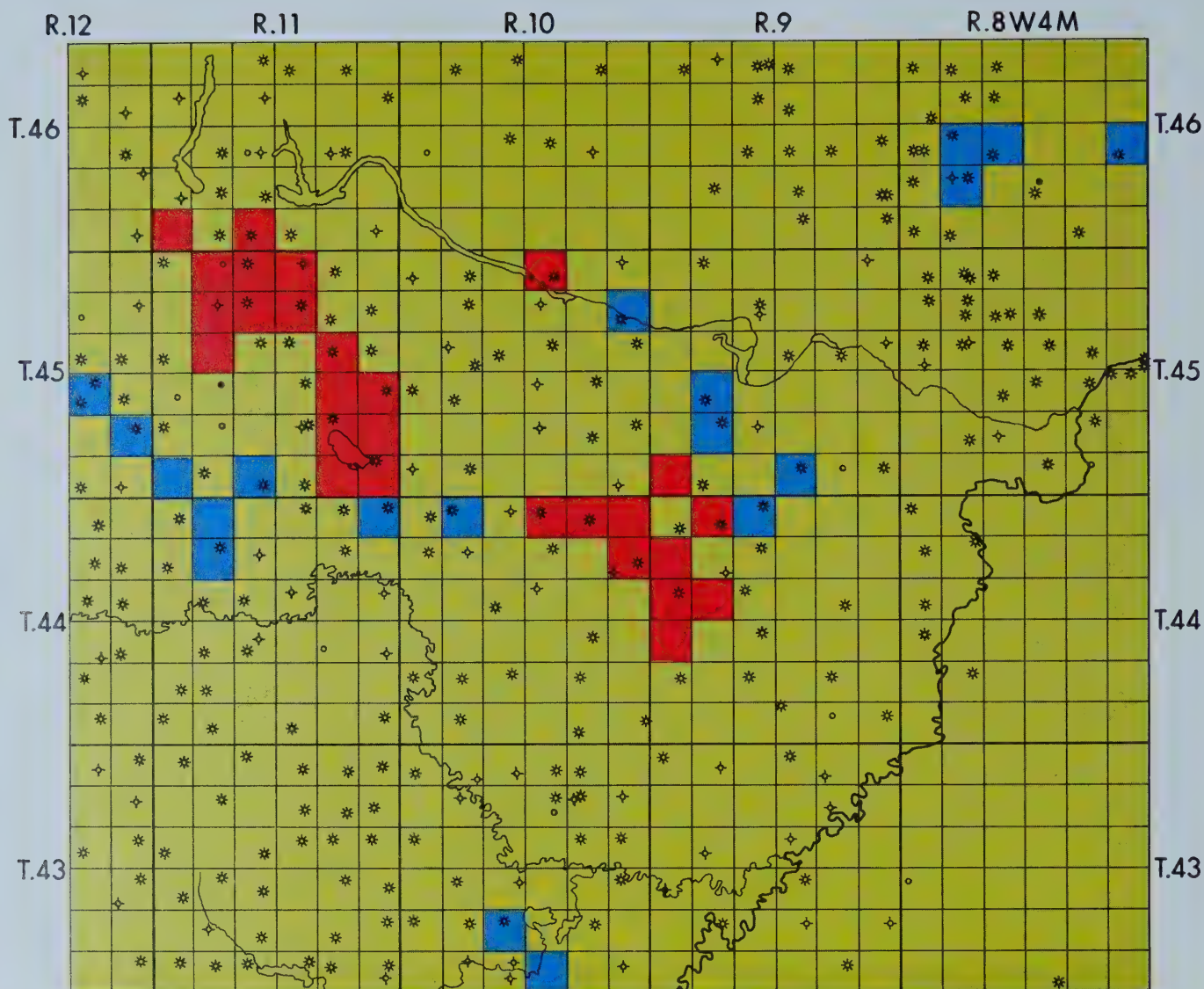
MORSE RIVER AREA

MERLAND's land ownership in this new region was achieved by participating in the drilling of a well located some 25 miles southeast of the Swan Hills oilfield in Alberta.

Although the well was not productive, MERLAND's participation in this drilling resulted in the acquisition of an 8.33% interest in 5,120 gross acres of land, thus providing a relatively low cost entry into an area which has subsequently experienced significantly escalating prices at Crown land sales.

This established foothold allows MERLAND the opportunity to pursue new developments in this region.





JARROW & BIRCH WAVY

JARROW - BIRCH WAVY AREA

1977 was a significant year for MERLAND's operations at the Jarrow gas producing area, located some 95 miles southeast of Edmonton, Alberta, as the Company continued to take advantage of production opportunities through its existing gas sales contract.

Several farmout agreements were negotiated with surrounding landowners, providing MERLAND with the opportunity to drill a total of 11 new wells, ten of which were completed as productive gas wells and one was abandoned.

In addition, MERLAND purchased a net 25% interest in five shut-in gas wells and a 100% interest in an additional three gas wells in the area.

Upon completion of this land acquisition program, gross land ownership increased by approximately 50% in the Jarrow area and by 100% in the Birch Wavy area.

MERLAND will continue to actively pursue additional lands in this area.

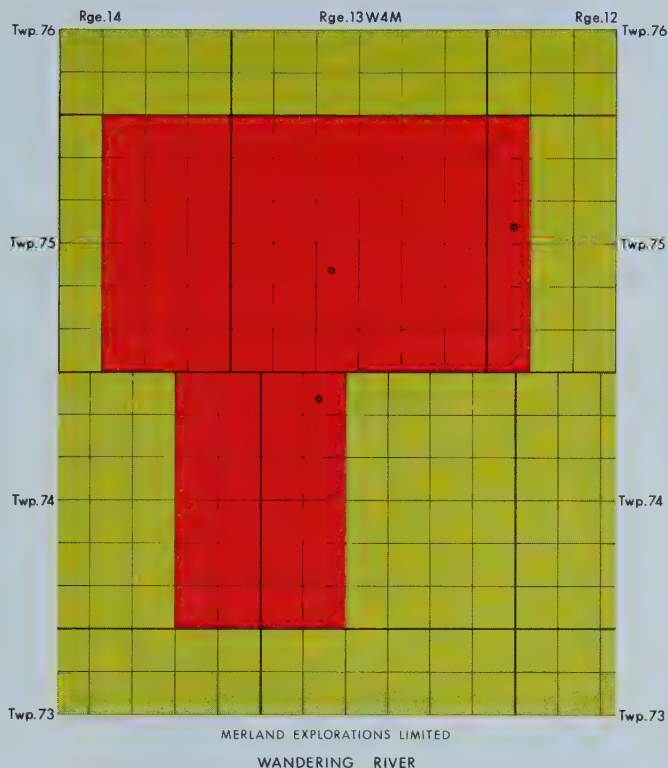
WANDERING RIVER, ALBERTA

MERLAND and Bow Valley Industries Ltd. acquired a 100% W.I. in 53,120 gross acres within the Wandering River Area. The 53,120 gross acres contain 26,880 gross acres of leases plus 26,240 gross acres of natural gas licences. By virtue of the leases and licences, MERLAND and Bow Valley own all rights down to 25 feet into the Ireton Formation of the Devonian Age. The acquisition included three gas wells completed in the lower Mannville zone, one of which has a flow rate of 750 MCF/D.

The area has high potential for gas from the Lower Cretaceous Formation and offsets the Wandering River Field from which Bow Valley presently produces and sells gas. Bow Valley will be the operator of this new property.

This area has an immediate market as the gas produced will be sold for use in the Fort McMurray area.

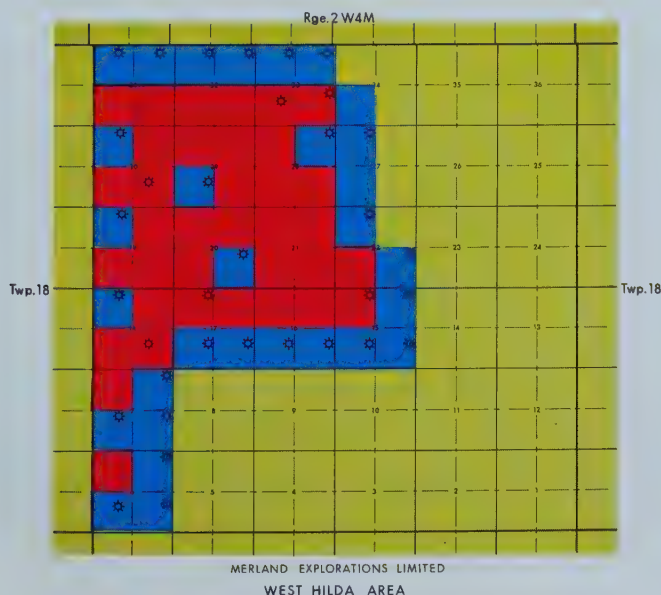
Plans are to pursue a multi-well drilling program in the 1978-1979 drilling season.



HILDA

MERLAND EXPLORATIONS LIMITED originally held a 25% Working Interest in the Hilda property. MERLAND and Coseka Resources jointly farmed-in an additional 25% Working Interest from Uno-Tex Petroleum Corporation. Under terms of this agreement, MERLAND and Coseka drilled 30 successful wells which earned MERLAND an additional 17.5% in the drilled sections until payout. After payout of the wells, MERLAND's net Working Interest will be 37.5%. MERLAND's interest is now 37.5% in all undrilled sections.

As a result of assuming the farmout, MERLAND's net acreage figure for the area has increased from 2,600 to 4,600 net acres.

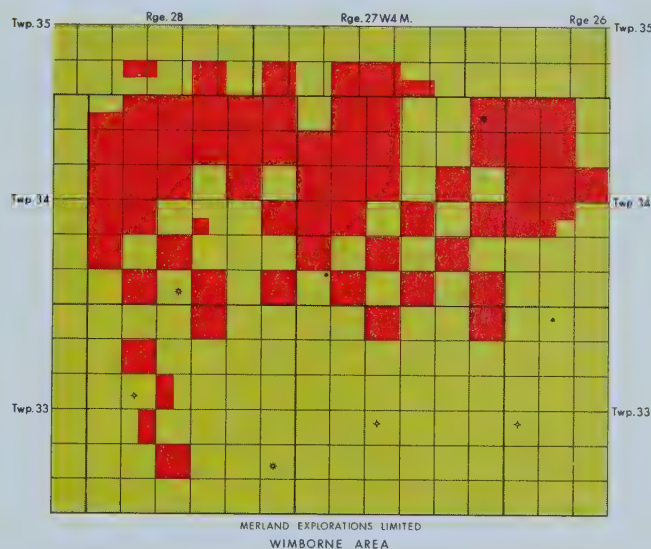


WIMBORNE AREA, ALBERTA

MERLAND entered into a participation agreement with Bridger Petroleum Corporation Ltd. for the exploration and development of oil and gas covering 42,720 gross acres in the Wimborne area of central Alberta. MERLAND's interest in the area is based on 15% of the interest farmed by Bridger, which is outlined on the accompanying plan. MERLAND participated in the drilling of eight wells resulting in five completed wells and three abandoned wells. One well located at 6-4-34-28-W4 was completed as a Basal Belly River oil discovery which is currently producing 200 barrels of oil per day from the main Belly River Sand.

By participating in the eight wells, MERLAND has earned approximately 6,000 net acres.

The participants in this project plan to conduct extensive seismic over the area, which should aid in the finding of additional oil and gas reserves. The area is located approximately 10 miles east of the town of Innisfail, Alberta.

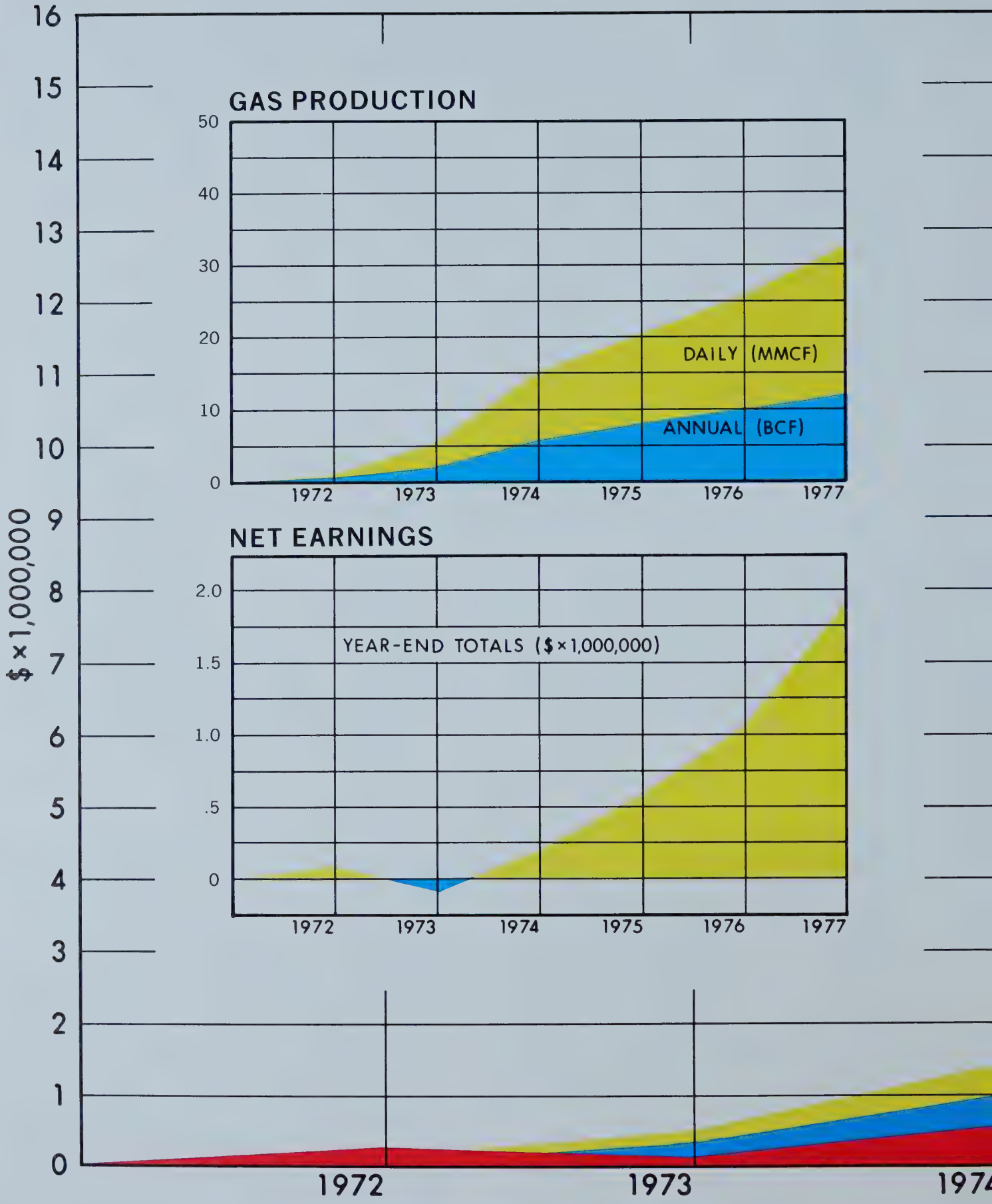


COWPAR LAKE, ALBERTA

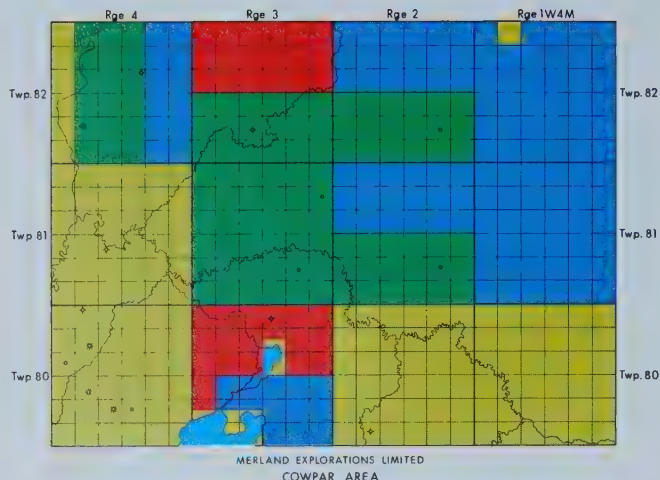
In October 1977 MERLAND, Bow Valley Industries Ltd. and Alminex Limited entered into a Joint Participation Agreement to explore for oil and gas in the Cowpar Lake Area of Alberta. The group subsequently obtained a farmout and option on 175,360 gross acres. To date, six wells have been drilled on this property, of which one has been completed as a gas well and five abandoned. These wells were drilled in extreme wildcat areas in order to fulfil earning provisions under the farmout agreement. By drilling the six wells, MERLAND has earned a 16 2/3 % Working Interest in 92,160 gross acres. Gravity and seismic surveys will be conducted to further evaluate this gas prone area.

The area has gas market potential to the tar sands development at Fort McMurray.

MERLAND and Bow Valley have an option to earn the balance of these lands during the 1978-1979 winter drilling season.



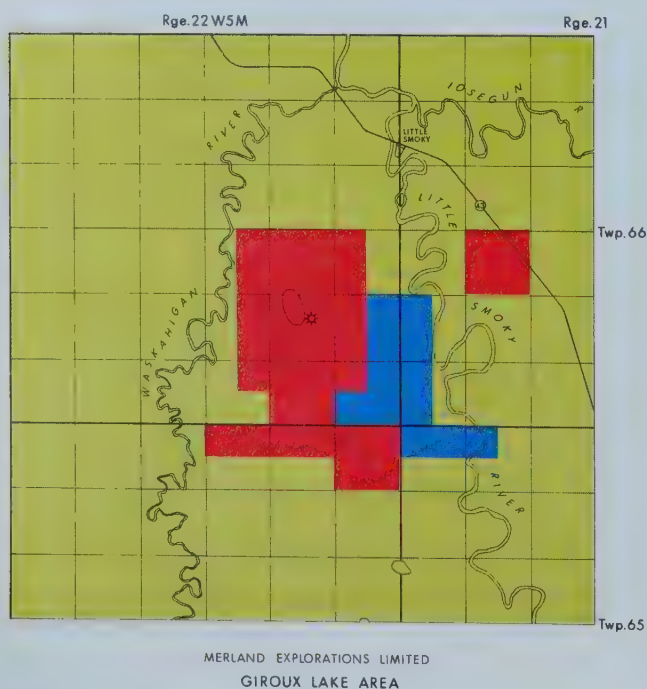




GIROUX LAKE, ALBERTA

On November 1, 1977, MERLAND EXPLORATIONS LIMITED, Tricentrol Canada Limited and Star Oil & Gas Ltd. entered into a participation agreement to explore for oil and gas within the Giroux Lake Area which is approximately 20 miles southwest of the town of Valleyview, Alberta. Under terms of a farmout from Gulf Oil Canada Limited, MERLAND, as operator, drilled a well located in Lsd 10-11-66-22 W5M to earn a net 33 1/3 % Working Interest in 3,200 gross acres. This well encountered encouraging oil and gas indications which have prompted the participants to increase their land holdings in the area.

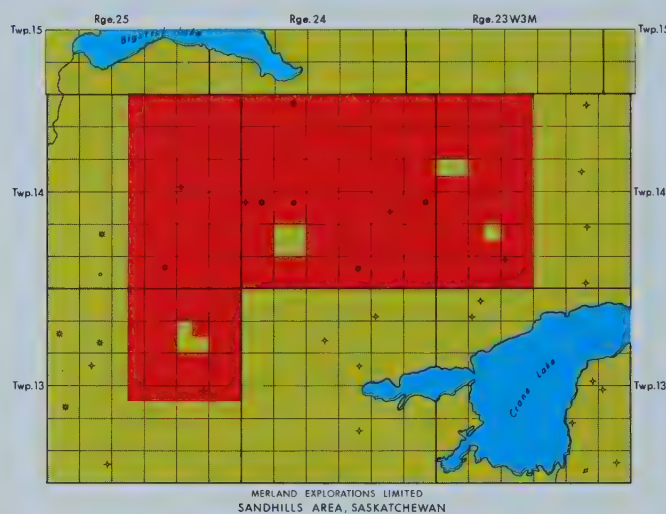
In addition to the acreage earned by the Gulf Farm-out, MERLAND holds a net 25% interest in 640 gross acres and 33 1/3 % interest in 1,600 gross acres containing all rights. MERLAND et al also have the option to drill a second well to earn an additional 1,920 gross acres of P&NG rights to depth drilled with an interest varying from 16 2/3 % to 33 1/3 %.



SAND HILLS, SASKATCHEWAN

MERLAND recently purchased a 100% W.I. in 54,194 acres of Milk River Rights in the Sand Hills Area. This acreage has high potential for Milk River gas production with proven gas reserves in excess of 200 BCF. The purchase included six completed gas wells.

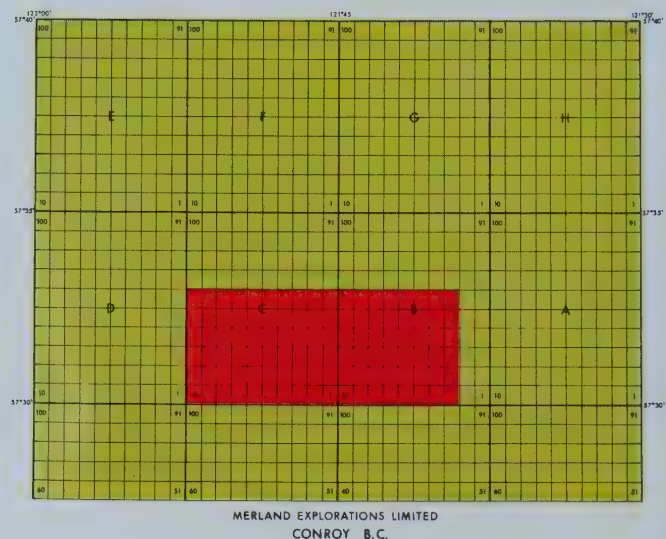
MERLAND anticipates commencing a multi-well program in the area during the 1978-79 drilling season with production expected from the area in 1979. The area is located approximately 25 miles west of Gull Lake, Saskatchewan.



CONROY, B.C.

MERLAND joined in the acquisition of a permit containing 18,550 gross acres in the Conroy area as a 33 1/3 % Working Interest. Cities Service, as operator for the project, has run extensive seismic over the area for evaluation purposes. MERLAND anticipates the drilling of its first well on the property during the 1978-1979 winter drilling season.

The area is located in the central northeast portion of the Province of British Columbia, approximately 12 miles northeast of the Laprise Creek Gas Field.



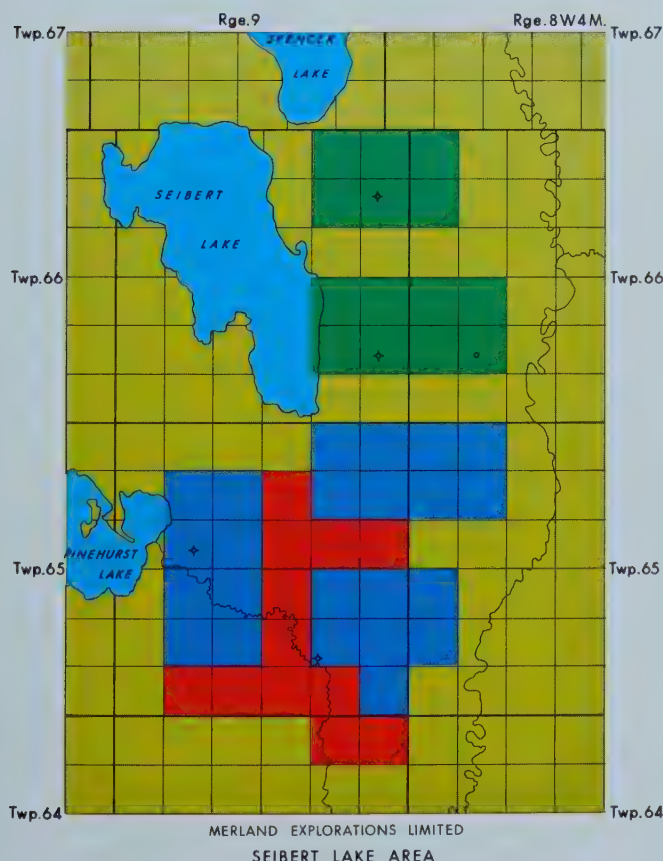
SEIBERT LAKE AREA

In November of 1977 MERLAND EXPLORATIONS LIMITED entered into a participation agreement with Bow Valley Industries Ltd. to explore for oil and gas in the Seibert Lake Area of Alberta. Activities commenced with the signing of a seismic option on lands consisting of 23,680 acres. MERLAND, as operator, has drilled two wells which have recently been abandoned. By drilling these two wells, MERLAND has earned a 25% W.I. in 8,960 gross acres and holds an option to earn a 25% W.I. in the balance of the acreage.

An extensive seismic program has since been conducted which has identified several anomalies in the area. This area has attracted several other oil and gas exploration companies which have drilled several productive wells currently held under tight-hole status. These activities have caused land prices in the area to escalate significantly which indicates favourable potential for the area.

In addition to the above acreage, MERLAND acquired a 33⅓% W.I. in 7,680 gross acres at a recent Alberta Crown Sale. This acreage is offset by three completed gas wells.

The area is located some 20 miles southeast of the Town of Lac La Biche, Alberta and is quite accessible for oil and gas exploration and development.



EAST TEXAS

During the year 1977 MERLAND was active in the East Texas Area with excellent results. During 1977 and up to the writing of this report, MERLAND participated in 21 wells resulting in the completion of eight gas wells, four oil wells and two dual oil and gas wells. MERLAND's interest in this area varies from a gross 10% to 26.6% in the various prospects. To date MERLAND holds 15,222 gross acres or 2,901 net acres in the area and will carry out additional drilling and acquire additional acreage as opportunities arise.

SOUTH AND SOUTHWEST TEXAS

During 1977 MERLAND expanded their search for oil and gas to South and Southwest Texas resulting in many new exciting prospects. At the writing of this report, MERLAND holds 126,130 gross acres or 16,799 net acres in the area.

During 1977 MERLAND participated in the drilling of 41 wells resulting in the completion of 22 productive and 19 abandoned wells. The results of the productive wells have been very satisfying to the Company and MERLAND will continue to pursue development and exploratory drilling in the various prospects during 1978. MERLAND will also be pursuing additional acreage within existing prospect areas plus additional acreage for new prospects.

OIL AND GAS RESERVES

As in 1976 MERLAND EXPLORATIONS LIMITED and MERLAND RESOURCES, INC. have had their reserves of oil, gas and natural gas liquids evaluated considering new reserves acquired and/or discovered during the year and oil and gas production obtained during the year.

The remaining net saleable proven and probable oil and natural gas liquids and natural gas reserves from our Canadian properties now total 882,000 barrels and 367 BCF respectively. Probable reserves constitute approximately 5% of these totals.

It is very difficult to accurately calculate our reserves of crude oil, natural gas and natural gas liquids in the United States at this time as most of these reserves have not been on production or have been on production for only a very short time. It is estimated however that MERLAND's United States reserves are approximately 30 BCF of natural gas and 300,000 barrels of crude oil and natural gas liquids. It is planned to more accurately determine these reserves once the properties have been on production for a minimal period of time.

These present natural gas reserves represent an increase of approximately 300% over 1976 and provide a reserve life expectancy of approximately 28 years at today's rate of production.

It is expected that MERLAND's reserves of crude oil and natural gas will increase dramatically over the next several years as exploration acreage is drilled and evaluated.



MERLAND EXPLORATIONS LIMITED

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF EARNINGS AND RETAINED EARNINGS

Year ended December 31, 1977
(with comparative figures for 1976)

	<u>1977</u>	<u>1976</u>
REVENUE		
Sales of gas and oil production	\$14,467,184	\$ 9,147,939
Less royalties	<u>5,083,990</u>	<u>3,450,313</u>
	9,383,194	5,697,626
Gain on sale of petroleum and natural gas interests	79,143	374,423
Interest and other	<u>53,873</u>	<u>119,032</u>
	<u>9,516,210</u>	<u>6,191,081</u>
EXPENSES		
Production	2,447,731	1,452,531
General and administrative	963,002	810,599
Organization and share issue expense	134,819	—
Interest on long-term debt	1,450,615	1,152,883
Depletion	1,682,049	1,015,520
Depreciation	<u>734,180</u>	<u>473,238</u>
	<u>7,412,396</u>	<u>4,904,771</u>
EARNINGS BEFORE INCOME TAXES	<u>2,103,814</u>	<u>1,286,310</u>
INCOME TAXES (Note 8)		
Deferred	1,082,616	748,389
Alberta royalty tax credit	<u>(893,642)</u>	<u>(603,876)</u>
	<u>188,974</u>	<u>144,513</u>
NET EARNINGS	<u>1,914,840</u>	<u>1,141,797</u>
Retained earnings (deficit) at beginning of year	<u>739,719</u>	<u>(402,078)</u>
RETAINED EARNINGS AT END OF YEAR	<u>\$ 2,654,559</u>	<u>\$ 739,719</u>
EARNINGS PER SHARE (Note 9)	<u>32.4 cents</u>	<u>22.7 cents</u>

See accompanying notes to consolidated financial statements.

MERLAND EXPLORATIONS LIMITED

AND SUBSIDIARY COMPANIES

CONSOLIDATED BALANCE SHEET

December 31, 1977
(with comparative figures for 1976)

Assets

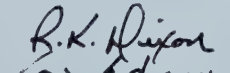
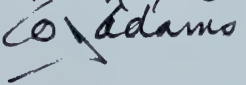
	<u>1977</u>	<u>1976</u>
CURRENT ASSETS		
Cash	\$ —	\$ 28,999
Accounts receivable	3,479,908	3,509,982
Mortgage receivable	—	100,000
Prepaid expenses and other	<u>181,242</u>	<u>50,534</u>
	3,661,150	3,689,515
PROMISSORY NOTE due October 7, 1980 (Note 2)	212,000	—
PIPELINE AID IN CONSTRUCTION LOAN (Note 3)	366,936	—
PROPERTY, PLANT AND EQUIPMENT (Note 4)		
Petroleum and natural gas interests and production equipment	34,854,966	24,777,941
Accumulated depletion and depreciation	<u>(4,982,082)</u>	<u>(2,576,004)</u>
	29,872,884	22,201,937
ORGANIZATION AND SHARE ISSUE EXPENSE	—	134,819
OTHER	8,997	8,997
	<u>\$34,121,967</u>	<u>\$26,035,268</u>

See accompanying notes to consolidated financial statements.

Liabilities

	<u>1977</u>	<u>1976</u>
CURRENT LIABILITIES		
Outstanding cheques less cash on deposit	\$ 568,472	\$ —
Demand bank loan	1,094,200	1,000,000
Accounts payable and accrued liabilities	4,223,643	2,427,722
Current portion of long-term debt (Note 5)	<u>2,285,760</u>	<u>2,285,760</u>
	8,172,075	5,713,482
 PREPAYMENTS ON FUTURE NATURAL GAS DELIVERIES	 —	 71,296
 LONG-TERM DEBT (Note 5)	 14,330,140	 14,098,400
 DEFERRED INCOME TAXES	 2,677,455	 1,594,839
 COMMITMENTS (Note 6)		

Shareholders' Equity:

SHARE CAPITAL (Note 7)		
Authorized—7,500,000 shares without par value.		
Issued—5,934,777 shares (1976—5,072,800)	6,287,738	3,817,532
RETAINED EARNINGS	<u>2,654,559</u>	<u>739,719</u>
	8,942,297	4,557,251
 On behalf of the Board:		
  , Director	 <u>\$34,121,967</u>	 <u>\$26,035,268</u>
 , Director		

MERLAND EXPLORATIONS LIMITED

AND SUBSIDIARY COMPANIES

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

Year ended December 31, 1977
(with comparative figures for 1976)

	<u>1977</u>	<u>1976</u>
SOURCE OF FUNDS		
Funds from operations	\$ 5,469,361	\$ 3,106,160
Proceeds from repayment of mortgage	—	100,000
Increase in long-term bank loan	4,600,000	5,662,240
Proceeds from issue of share capital	2,470,206	753,000
Sale of property, plant and equipment	333,413	863,866
	<u>12,872,980</u>	<u>10,485,266</u>
APPLICATION OF FUNDS		
Purchase of property, plant and equipment	10,341,446	7,699,869
Repayment of long-term bank loan	2,285,760	1,948,340
Conversion of income debentures to share capital	2,082,500	417,500
Reduction of prepayments of future natural gas deliveries	71,296	92,294
Loan to an officer and director	212,000	—
Funds advanced under pipeline aid in construction loan	366,936	—
	<u>15,359,938</u>	<u>10,158,003</u>
INCREASE (DECREASE) IN WORKING CAPITAL DEFICIENCY	2,486,958	(327,263)
Working capital deficiency at beginning of year	2,023,967	2,351,230
WORKING CAPITAL DEFICIENCY AT END OF YEAR	<u>\$ 4,510,925</u>	<u>\$ 2,023,967</u>

See accompanying notes to consolidated financial statements.

AUDITORS' REPORT

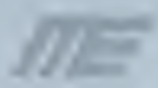
TO THE SHAREHOLDERS' OF MERLAND EXPLORATIONS LIMITED

We have examined the consolidated balance sheet of Merland Explorations Limited as at December 31, 1977 and the consolidated statements of earnings and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1977 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Canada
March 24, 1978

Peat, Marwick, Mitchell & Co.
Chartered Accountants



MERLAND EXPLORATIONS LIMITED

AND SUBSIDIARY COMPANIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1977

1. Significant accounting policies

(a) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly-owned.

(b) Petroleum and natural gas interests

The costs of acquiring interests in proven and unproven petroleum and natural gas properties and the related costs of development are capitalized on an area of interest basis. Depletion and depreciation are provided on property costs, including costs of development of productive wells, on the unit of production method based on the related proven reserves of petroleum and natural gas as estimated by independent engineers. The costs of non-productive areas are charged to expense when properties are abandoned or surrendered.

(c) Income taxes

The Company follows the tax allocation method of accounting for all timing differences between taxable income and recorded earnings. Under this method, provision for deferred income taxes is made on the excess of deductions for income tax purposes over the related depletion, depreciation and other charges recorded in the financial statements.

(d) Translation of foreign currencies

The accounts of the Company's wholly-owned foreign subsidiary are translated to Canadian dollars as follows:

Current assets and liabilities and the promissory note at the exchange rate prevailing at the end of the year;

Property, plant and equipment on the basis of rates of exchange prevailing at the dates of acquisition;

Revenue and expenses at average rates during the year except for depletion and depreciation provisions, which are translated on the same basis as the property, plant and equipment.

All gains and losses arising from translation of foreign currencies are credited or charged to income.

2. Promissory note due October 7, 1980

The promissory note, which does not bear interest, represents funds advanced by a subsidiary to an officer and director for the purchase of shares of Merland Explorations Limited.

3. Pipeline aid in construction loan

Funds advanced under the above loan represent the Company's share of prepaid pipeline construction costs under a gas sales contract. The loan will be repaid at a fixed amount per MCF of gas throughput.

4. Property, plant and equipment

	December 31, 1977			1976
	Cost	Accumulated Depletion and Depreciation	Net Book Value	Net Book Value
Canada				
Petroleum and natural gas interests	\$21,152,215	\$3,264,468	\$17,887,747	\$14,338,150
Production equipment, gas plants and other equipment	<u>9,011,867</u>	<u>1,539,672</u>	<u>7,472,195</u>	<u>5,967,040</u>
	<u>30,164,082</u>	<u>4,804,140</u>	<u>25,359,942</u>	<u>20,305,190</u>
United States				
Petroleum and natural gas interests	4,165,556	157,875	4,007,681	1,764,425
Production equipment, gas plants and facilities	<u>525,328</u>	<u>20,067</u>	<u>505,261</u>	<u>132,322</u>
	<u>4,690,884</u>	<u>177,942</u>	<u>4,512,942</u>	<u>1,896,747</u>
Total	<u>\$34,854,966</u>	<u>\$4,982,082</u>	<u>\$29,872,884</u>	<u>\$22,201,937</u>

Certain of the Canadian petroleum and natural gas properties are pledged as security for the bank loan (Note 5).

5. Long-term debt

	1977	1976
Bank loan	\$16,615,900	\$14,301,660
7% convertible income debentures, Series A, due October 1, 1983	<u>—</u>	<u>2,082,500</u>
	16,615,900	16,384,160
Less current portion of bank loan included in current liabilities	<u>2,285,760</u>	<u>2,285,760</u>
	<u>\$14,330,140</u>	<u>\$14,098,400</u>

The bank loan bears interest at 1% above bank prime rate and is secured by assignments covering the Company's interest in various Canadian petroleum and natural gas properties together with a specific assignment of production proceeds on the properties pledged. The agreed terms of repayment, although the loan is a demand loan, provide for equal monthly installments of principal and interest (Note 13).

During the year ended December 31, 1977 all of the outstanding 7% convertible income debentures were converted into share capital as set out in Note 7.

6. Commitments

In addition to other commitments incurred in normal exploration activities, the Company is committed to completing an exploratory and development programme in 1978, the amount of which is approximately U.S. \$1,344,000.

7. Share capital

During the year, the following shares were issued:

	1977		1976	
	Number	Value	Number	Value
On conversion of \$2,082,500 (1976—\$417,500) principal amount of 7% convertible income debentures	749,700	\$2,082,500	150,300	\$417,500
Issued for cash:				
To an officer and director (Note 2)	80,000	212,000	—	—
To trustee of deferred profit sharing plan	8,159	37,531	—	—
Under employee share purchase plan	19,118	122,175	—	—
Upon exercise of share options	5,000	16,000	260,000	335,500
	<u>861,977</u>	<u>\$2,470,206</u>	<u>410,300</u>	<u>\$753,000</u>

Options to acquire 15,000 shares were granted to employees, none of whom were officers or directors, at a price of \$3.85 per share exercisable up to October 5, 1980.

At December 31, 1977 options granted to employees to purchase shares of the company were outstanding as follows:

Expiry date	Number	Option price
June 14, 1979	15,000	\$3.20
October 5, 1980	15,000	\$3.85
	<u>30,000</u>	

8. Income taxes

The provision for income taxes differs from the result which would be obtained by applying the combined Canadian Federal and Provincial income tax rate of 47% to the earnings before income taxes. This difference results from the following items:

	1977		1976	
	Amount	% of earnings before income taxes	Amount	% of earnings before income taxes
Computed expected tax	\$ 988,793	47.0	\$ 604,566	47.0
Increase (decrease) in taxes resulting from:				
Net loss of subsidiaries	3,543	.2	4,966	.4
Royalties and other payments to provincial governments	1,718,229	81.7	1,149,795	89.4
Provincial rebate	(184,485)	(8.8)	(137,810)	(10.8)
Alberta Royalty tax credit	(893,642)	(42.5)	(603,876)	(46.9)
Federal resource allowance	(1,022,333)	(48.6)	(641,939)	(50.0)
Tax depletion on Canadian production income	(399,955)	(19.0)	(291,666)	(22.7)
Other	(21,176)	(1.0)	60,477	4.7
Provision for income taxes	<u>\$ 188,974</u>	<u>9.0</u>	<u>\$ 144,513</u>	<u>11.1</u>

9. Earnings per share

The exercise of outstanding share options would have no dilutive effect on earnings per share.

10. Comparative figures

Certain amounts have been reclassified to conform to current presentation.

11. Statutory information

During the year the Company had twelve directors and six officers, two of whom were directors. Aggregate remuneration paid to officers for their services was \$183,308 (1976 — \$187,518 eight officers) and to directors for their services was \$53,900 (1976 — \$23,100 twelve directors).

12. Anti-Inflation Act

The Company is subject to the dividend restrictions of the Anti-Inflation Act.

13. Subsequent event

Pursuant to a letter of intent the Company is negotiating an agreement with a Canadian chartered bank for the issuance of income debentures in the principal amounts of \$20,000,000 and U.S. \$7,000,000 to be secured by an assignment of certain Canadian petroleum and natural gas properties. It is anticipated that the term of the debentures will be ten years at interest rates currently prevailing for such securities. Principal repayments will commence in the sixth year of the term of the financing. The proceeds from these debentures will be used to repay existing bank loans and provide new funds for further petroleum and natural gas exploration and development.



MERLAND EXPLORATIONS LIMITED

HEAD OFFICE

402 Fina Building,
736 Eighth Avenue S.W.,
Calgary, Alberta T2P 1H4
Telephone — (403) 269-2511

SUBSIDIARY COMPANIES

Amerco Investments Limited
Merland Resources, Inc.
Northwest Oils Limited
Parquet Flooring Company Limited

AUDITORS

Peat, Marwick, Mitchell & Co.

BANKERS

The Royal Bank of Canada

REGISTRAR AND TRANSFER AGENT

Guaranty Trust Company of Canada
Calgary, Alberta
Toronto, Ontario
Vancouver, B.C.

DIRECTORS

Walter J. Adams, Edmonton, Alberta
Robert K. Dixon, Calgary, Alberta
George E. Gathercole, Toronto, Ontario
Robert Law, Q.C., Toronto, Ontario
Brian D. Marshall, Toronto, Ontario
Wilmot L. Matthews, Toronto, Ontario
William O. Parlee, Q.C., Edmonton, Alberta
Harry J. Richardson, Alton, Ontario
George T. Smith, Toronto, Ontario
Donald J. Wilkins, Toronto, Ontario

OFFICERS

Robert K. Dixon, President
Allan P. Markin, Vice-President - Operations
Peter W. Kreutzer, Treasurer
Robert Law, Q.C., Secretary

SENIOR PERSONNEL

Douglas A. Weston, Exploration Manager
George N. Betts, Land Manager

The Annual Meeting of the Shareholders will be held
on June 22, 1978 at 9:00 a.m. in the Rideau Room,
Calgary Inn, Calgary, Alberta.



MERLAND EXPLORATIONS LIMITED
1977 Annual Report